No. 2824

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of SOUTHERN ARIZONA SMELTING COMPANY, a Corporation, Bankrupt,

M. P. FREEMAN, as Trustee in Bankruptcy of SOUTHERN ARIZONA SMELTING COMPANY, a Corporation, Bankrupt,

vs. *Appellant,*

JOHN H. MARTIN, as Trustee in Bankruptcy of IMPERIAL COPPER COMPANY, a Corporation, Bankrupt, *Appellee.*

ADDITIONAL BRIEF ON BEHALF OF APPELLANT.

EVERETT E. ELLINWOOD,
JOHN M. ROSS,
LESLIE C. HARDY,
Solicitors for Appellant,
Bisbee, Arizona.

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Appellant,

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Appellee.

STATEMENT

Appellant's counsel have filed in this cause a brief which treats generally upon all of his assignments of errors. It is our purpose, by this additional brief, to treat only upon the first assignment of error (Tr. 98) in so far as it relates to the following conclusion of law of the trial court:

> "That the Southern Arizona Smelting Company, a corporation, was a subsididary of the Imperial Copper Company, a corporation, created and used by the Imperial Copper Company for its convenience in the transaction of its business; that said Imperial Copper

Company was the parent corporation of said Southern Arizona Smelting Company, and used said Southern Arizona Smelting Company as an adjunct, agent and instrumentality in the transaction of its business." (Tr. 92.)

This controversy involves a suit between appellant, as trustee of the Imperial Copper Company (hereinafter called Copper Company), and appellee, as trustee of the Southern Arizona Smelting Company (hereinafter called Smelting Company), for the ownership and possession of a certain quantity of flue dust and a slag dump situate upon the premises of appellee. In support of its conclusion of law that the appellee is entitled to the ownership and possession of this flue dust and slag dump, the trial court found, first, that the appellee was used as the "adjuncct, agent and instrumentality" in the transaction of appellant's business; and, secondly, that the contract between appellant and appellee for smelting the former's ores constituted a bailment and not a sale. (Tr. 92.)

The conclusion of law of the trial court that the Smelting Company was used as the mere "adjunct, agent and instrumentality" of the Copper Company is, in our opinion, so important, as a precedent for the conduction of corporate business, and so palpably erroneous, in view of the findings of fact, that we deem it necessary to discuss it separately.

ARGUMENT

It is not disputed that the Copper Company was the owner of practically all the issued stock of the Smelting Company before this stock was judicially sold to satisfy a lien of a deed of trust executed by the Copper Company to the Bankers Trust Company (Tr. 90) which antedated the findings of fact and conclusion of law. By virtue of this stock ownership, at that time, the relationship of holding corporation and subsidiary existed between the Copper

Company and the Smelting Company, respectively, but this did not necessarily make the latter the "adjunct, agent or instrumentality" of the former.

> "The mere fact that the stockholders in two or more corporations are the same, or that one corporation exercises control over the other through ownership of its stock, or through identity of its stockholders, does not make either the agent of the other, nor does it merge them into one, so as to make a contract of one corporation binding upon the other, where each corporation is separately organized under a distinct charter. (Citation of authorities.) True, the legal fiction of a distinct corporate existence will be disregarded when necessary to prevent fraud, or when a corporation is so organized and controlled and its affairs so conducted, 'as to make it only an adjunct, or instrumentality of another corporation.' (Citation of Authorities.) But, 'it requires a strong case to induce a court of equity to consider two corporations as one, on account of one owning all of the capital stock of the other.' (Citation of authorities.)"
>
> *Pittsburg & Buffalo Co. v. Duncan, et al., 232 Fed. 584.*

The foregoing is a late and clear statement of the rule for determining when one corporation should be considered the adjunct, agent or instrumentality of another. It does not result merely from stock ownership. Nor does such a relationship exist when it appears that a separate organization is maintained and a separate business is conducted. The case of *In re Watertown Paper Company, 169 Fed. 252,* is illustrative of this. In that case the stockholders of the Watertown Paper Company organized a separate corporation and called it the H. Remington & Son Pulp & Paper Company. The stock of one was virtually owned by the stockholders of the other. The Pulp Company was financed, during its organization period, from the funds of the Paper

Company. The Paper Company became bankrupt and the Pulp Company presented its claim for merchandidse furnished by it to the Paper Company. The claim was rejected, as was stated, because there was such an identity of corporate interests that a claim presented by the one against the other was nothing more or less than the bankrupt presenting a claim against itself. The Circuit Court of Appeals, however, in reversing the District Court, said:

> "The case thus presented is one in which the stockholders of two corporations are largely the same, in which both corporations have been under the same management, and in which their affairs have for years been involved and intermingled; and the legal question is whether these relations prevent the one corporation from enforcing against the bankrupt estate of the other a claim which, in case the latter corporation had remained solvent, would have been both valid and enforceable. * * * *"
>
> "Now it is an elementary and fundamental principle of corporation law that a corporation is an entity separate and distinct from its stockholders *and from other corporations with which it may be connected.* (Italics ours.) The fact that the stockholders of two separately chartered corporations are identical, that one owns shares in another, and that they have mutual dealings, will not, as a general rule, merge them into one corporation, or prevent the enforcement against the insolvent estate of the one of an otherwise valid claim of the other. As said by the Supreme Court of Arkansas, in *Lange v. Burke, 69 Ark. 85. 88, 61 S. W. 165,* in holding, in a case where two corporations were practically controlled by the same stockholders and had had intimate business relations, including the employment of the same bookkeeper, that a claim of one corporation would be enforced against the estate of the other:
>
> " 'A corporation is an artificial being, separate and distinct from its agents, officers, and stockholders. Its

dealings with another corporation, although it may be composed in part of persons who own a majority of the stock in each company, and may be managed by the same officers, if they be in good faith and free from fraud, stand upon the same basis, and affect it and the other corporation in the same manner and to the same extent, that they would if each had been composed of different stockholders and controlled by different officers.' "

And as said by the Circuit Court of Appeals for the Sixth Circuit in *Richmond, etc., Const. Co. v. Richmond, etc., R. Co., 68 Fed. 105, 108, 15 C. C. A. 289, 34 L. R. A. 625:*

" 'The contract company was a legal corporation, wholly distinct and separate from the railroad company. The fact that the stockholders in each may have been the same persons does not operate to destroy the legal identity of either corporation. Neither does the fact that the one corporation exercised a controlling influence over the other, through the ownership of its stock or through the identity of stockholders, operate to make either the agent of the other, or to merge the two corporations into one.' "

With this premise the court thereupon makes the following conclusion:

"Unless, therefore, it can be shown that some exception to the general rule of separate corporate existence and liability applies in this case, it must follow that the claim of the Pulp Company should have been allowed. The only exceptions to that rule possibly applicable here are: (1) The legal fiction of distinct corporate existence will be disregarded, when necessary to circumvent fraud. (2) It may also be disregarded in a case where a corporation is so organized and controlled, and its afairs are so conducted, as to make it merely an instrumentality or adjunct of another corporation."

* * * * * * *

"It is true that the two corporations mingled their

affairs. A creditor of the one company might perhaps have a claim, based upon principles of estoppel, against the other. Lax business methods are clearly shown. Undoubtedly the controlling stockholders regarded the two corporations as being, in a general way, different departments of their business. But the separate corporate organizations were apparently kept up. Each corporation had its own creditors, its own assets, and conducted its business in its own name. Books of account were kept, showing their financial relations. The stockholders were not entirely the same. We cannot, upon these facts, hold that the corporations were identical, nor that the Pulp Company was merely an adjunct or instrumentality of the Paper Company. Instead of coming under the exceptions, this case seems clearly to come within the general rule that the distinct corporate existence of two separate although associated corporations will be regarded by the courts."

From the decisions of the Circuit Court of Appeals for the Sixth Circuit in the case of *Pittsburgh & Buffalo Co. v. Duncan, et al., Supra,* and of the Circuit Court of Appeals for the Second Circuit in the case of *In re Watertown Paper Co., Supra,* we deduce the following:

(1) The mere fact that one corporation exercises control over another by virtue of stock ownership, or through identity of stockholders, does not merge them into one and destroy their corporate existence.

(2) Where separate corporate organizations are actually maintained, even though there be a unity of interest and control, one corporation will not be judicially considered the adjunct, agent and instrumentality of the other.

(3) The general rule that a corporation is an entity, separate and apart from its stockholders, will be regarded, unless necessary to circumvent fraud, and where one corporation is the adjunct, agent and instrumentality of another, and then only in the clearest cases.

There is no imputation of fraud in the case at bar, so we may at once eliminate that exception to the general rule of separate corporate existence. If the statement of facts discloses that the Smelting Company is the adjunct, agent and instrumentality of the Copper Company, it must be because of the remaining exception to the general rule, and then only because of the clearest reason.

We confidently assert that the findings of fact disclose that both the Copper Company and the Smelting Company maintained separate corporate organizations and disjointly exercised their corporate privileges. Let us briefly analyze the statement of facts.

Immediately after the organization of the Smelting Company, contracts were executed with it by the Copper Company for building a smelter. These contracts were based upon a valuable consideration, namely, the transfer of 7,995 shares of stock of the Smelting Company to the Copper Company, and the smelting of the latter's ores, the Copper Company in turn constructing the smelter and furnishing the premises upon which the smelter was constructed. (Tr. 47 et. seq. and 63 et. seq.)

About the time the Smelting Company was ready to begin operations it executed a contract, as party of the first part, with the American Metal Company, Limited, as party of the second part, and the Copper Company, as party of the third part, for refining the bullion to be smelted by the Copper Company. This contract was executed by the Smelting Company in its individual, corporate capacity. (Tr. 52 et seq.)

The ores shipped by the Copper Company to the Smelting Company were assayed by an agent of both companies. (Tr. 67.) Smelter returns were made by the Smelting Company and delivered to the Copper Company. (Tr. 67.)

The value of the ores shipped to the Smelting Company

by the Copper Company was entered upon the books of both companies. The bullion was shipped by the Smelting Company to the American Metal Company and an "Account Sales" was rendered by the latter company to the Smelting Company, but the proceeds of the sale eventually reached the Copper Company. (Tr. 69.)

The Copper Company and the Smelting Company kept separate books, and accounts between them were balanced monthly. (Tr. 72.)

The Copper Company kept all funds realized from smelting and refining the ores, and paid the bills of the Smelting Company, the amount of which ~~were~~ was charged against the account of the last-named company. (Tr. 72.)

Both companies kept an account of the coke and flux purchased. (Tr. 73.)

The trustee in bankruptcy of the Copper Company brought suit against the Smelting Company upon a balance due for moneys paid for the Smelting Company on account of labor, materials, etc. (Tr. 74.)

The creditors of the Smelting Company presented their claims to it for adjudication and not to the Copper Company. (Tr. 81.)

The Copper Company issued its mortgage bonds to the Bankers Trust Company, and secured them with a deed of trust conveying all of its real and personal property. (Tr. 44.) Thereafter, as further security, the stock of the Smelting Company, owned by the Copper Company, was pledged to the Bankers Trust Company. (Tr. 81.) Thereafter suit was filed to foreclose the deed of trust, so executed, and said stock, among other property, was sold to pay said bonded indebtedness. (Tr. 87.)

We have synopsised the statement of facts to show that both the Copper Company and the Smelting Company

maintained separate corporate organizations. The Copper Company itself recognized the separate corporate entity of the Smelting Company, because it brought suit in its corporate capacity against the Smelting Company in its corporate capacity, for debt. (Tr. 74.) The bankruptcy creditors of the Copper Company evidently considered the Smelting Company a separate entity when they filed their claims against it and not the Copper Company. (Tr. 81.) Indeed, the conclusion of law of the trial court that "the contract under which said ores were so shipped by the Imperial Copper Company, and smelted by the Southern Arizona Smelting Company, constituted a bailment and not a sale" (Tr. 92) seems to completely refute the conclusion of law, of which we now complain, that the Smelting Company was the adjunct, agent and instrumentality of the Copper Company. How could there be a contract of bailment between the Copper Company and the Smelting Company if there was no separateness of corporate existence between them? It is just as impossible for a corporation to contract with itself as it is for an individual, and this is what the trial court said the Copper Company did by its conclusion of law that the Smelting Company was used as the adjunct, agent and instrumentality of the Copper Company, for by so finding it absolutely merged the two corporations and thereby destroyed their separate corporate entity. *Pittsburgh & Buffalo Co. v. Duncan, et al.,* and *In re Watertown Paper Company, Supra.*

Apparently, the learned trial court concluded that, at the time of the organization of the Smelting Company, and until the Copper Company ceased to own any of its stock, the Smelting Company was used as a mere adjunct or instrumentality of the Copper Company. But when the Copper Company, through the pledge and foreclosure above mentioned, ceased to be the owner of any stock in the Smelt-

ing Company the link which connected them was broken and the Smelting Company thenceforward must be treated as a distinct corporate entity. As appears from the findings of fact, when the Copper Company went into bankruptcy, it was not the record owner of any of the shares of stock of the Smelting Company. The trustee in bankruptcy of the Copper Company therefore must take the condition as he found it and manifestly could claim no better title to the capital stock of the Smelting Company than that held by the Copper Company at the date of adjudication. Considering the matter in this light the trial court evidently concluded that, although the Smelting Company was originally organized and used as a mere instrumentality or adjunct of the Copper Company, it could no longer be treated as such, but, in view of the condition of stock ownership, above mentioned, subsisting when the Copper Company was adjudicated a bankrupt, and when the petition in bankruptcy was filed against it, the corporate identity of the Smelting Company must be recognized. Therefore it was concluded that the Copper Company and Smelting Company might contract with each other and that the Smelting Company could be made the bailee of the Copper Company. The trial court's conclusion that the Smelting Company was used as a mere instrumentality, *et cetera,* of the Copper Company therefore became immaterial and irrelevant so far as the issues in this proceeding were concerned.

It seems that every one of the findings of fact negative the conclusion of law that the Smelting Company was the "adjunct, agent and instrumentality" of the Copper Company. At the most it cannot be said that this is a case sufficiently clear to disregard the separate existence of the two corporations. For our part we cannot see any distinction between the facts here involved and those disclosed in the case of *In re Watertown Paper Co., Supra.* If there the

Paper Company and Pulp Company maintained separate corporate organizations, then here the Copper Company and Smelting Company certainly did so.

No matter how this litigation may terminate, it will doubtless be conceded by everyone that the creditors of the Smelting Company have a prior right to resort to the assets of the Smelting Company for satisfaction of their claims. If appellee's contentions are eventually sustained it would mean that the creditors of the Copper Company would be entitled to any surplus assets of the Smelting Company after the Smelting Company's creditors were paid in full. In other words, the creditors of the Copper Company would simply take unto themselves the equity which is now held by the purchasers of the Smelting Company's stock at foreclosure sale. It is inconceivable that the creditors of the Copper Company will ever be permitted, after the Copper Company has sold and disposed of its interest in the Smelting Company in satisfaction of its mortgage debt, to take that very property away from the purchasers at foreclosure and again make it a part of the assets of the Copper Company, unless, indeed, there should be some showing of fraud or conspiracy, which is not suggested in the record here. But the most that the creditors of the Copper Company could get would be a right to the surplus assets of the Smelting Company after its bona fide creditors are paid.

It appears from the findings that the time has long since passed within which the creditors of the Smelting Company might prove their claims against the Copper Company, if they had any basis for doing so. It cannot be certainly assumed that the assets of the Smelting Company, including the slag dump and flue dust involved in this proceeding, will be sufficient to satisfy the Smelting Company's debts and the costs of administration in the bankruptcy proceedings now pending against the Smelting Company. Upon

what theory, therefore, may the trustee of the Copper Company be permitted to proceed piecemeal to take away from the Smelting Company assets in which the Smelting Company's creditors have an equity prior to that of the Copper Company's creditors? If this slag dump and flue dust are taken away from the Smelting Company's creditors in this proceeding upon the theory that the Smelting Company was a mere dummy, then it may, and probably will, result that the Smelting Company's creditors will be unable to satisfy their just claims against this property in which they have a prior right. We are satisfied that the learned trial court, fully familiar with the many angles of litigation in which these companies are involved, would never have awarded this slag dump and flue dust to appellee except upon the theory that the Smelting Company held this property as bailee for the Copper Company, that is to say, upon the theory that the corporate entity and character of the Smelting Company may not be ignored but must be recognized and preserved. It is upon this theory alone that the conclusions of the trial court must rest if they are to be sustained. Therefore it is clear, for this additional reason, that the conclusion of the trial court that the Smelting Company was a mere dummy corporation was and is wholly irrelevant and immaterial.

CONCLUSION

As said at the outset, we felt constrained to separately impress upon this court the importance and, in our opinion, the palpably erroneous, immaterial and irrelevant conclusion of the trial court that the Smelting Company was used as an adjunct, agent and instrumentality of the Copper Company. We are sure that the trial court also erred in its remaining conclusion that the contract for smelting the ore

constituted a bailment and not a sale. So we contend the decision of the lower court should be reversed, and the case remanded with directions to enter a decree in favor of appellant as prayed for in his answer.

Respectfully submitted,

EVERETT E. ELLINWOOD,
JOHN M. ROSS,
LESLIE C. HARDY,
Solicitors for Appellant,
Bisbee, Arizona.